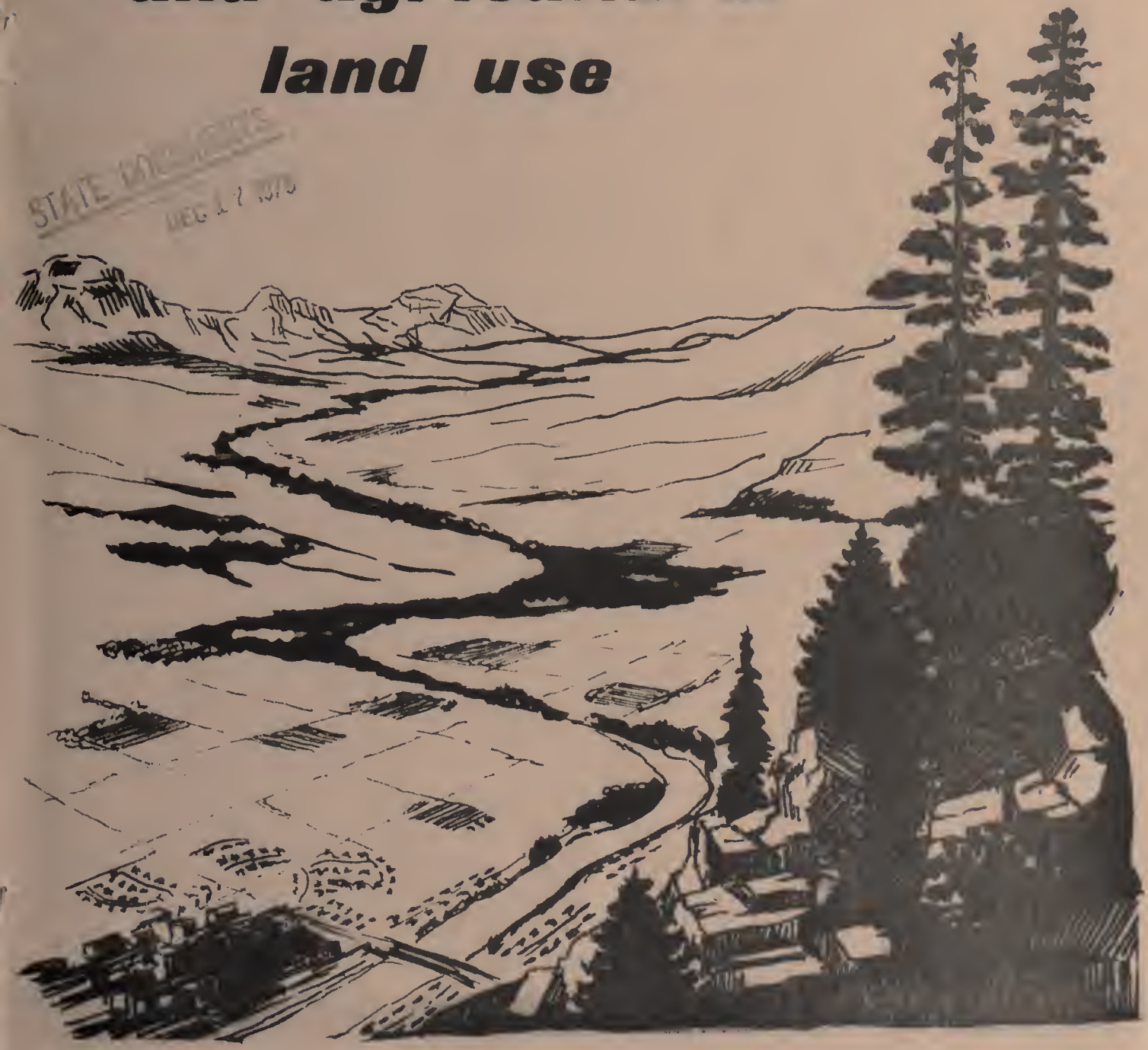
differential taxation and agricultural land use



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DIFFERENTIAL TAXATION AND AGRICULTURAL LAND USE

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DIFFERENTIAL TAXATION AND AGRICULTURAL LAND USE

Introduction

Few subjects engender as much controversy as has the ad valorem (according to value) property taxation system which provides the financial underpinnings for local government and education throughout the United States. The property tax, it is variously charged, discriminates against the rich, the poor, the farmer, the urbanite, the home owner and the industrialist. Critics of the tax, who seem to represent almost every segment of society, would have us believe that it compels city dwellers to subsidize rural residents (and vice versa), industry and agriculture to subsidize residential development, owners of stick-built houses to subsidize mobile home residents, and so forth.

To the state legislatures has fallen the difficult task of sorting out this myriad of conflicting claims and of modifying the property tax structure to better serve the illusive "public interest." The lawmakers have responded to this challenge by adopting a variety of palliative measures including so-called "circuit breaker" tax relief for senior citizens, preferential treatment for new industries, and tax incentives for the renovation of deteriorating buildings and blighted areas.

Since the late 1950's a good deal of legislative attention has been focused on the application of the property tax to the agriculturalist. One result of this scrutiny has been the enactment by over half of the 50 states,

including Montana[1], of some form of differential, or use-value assessment statute.

In simplest terms these statutes (which are frequently termed "greenbelt acts") seek to lighten the farmer's and rancher's property tax burden by providing that agricultural land, unlike other real property, is to be assessed not according to its market value, which may be distorted by non-agricultural influences, but according to its value for agricultural purposes.

Use-value laws fall into three categories -- those which simply provide for preferential assessment of agricultural land, those which combine preferential assessment with the imposition of a "roll back" penalty tax when agricultural land is converted to other uses, and those under which preferential assessment is contingent on the individual landowner's agreement to restrict development of his property. Montana's statute (Sections 84-437.1 through 84-437.17, R.C.M. 1947), typical of the "roll back" penalty approach, requires that when a property owner converts agricultural land to a non-agricultural use, he pays the difference between the taxes paid on the property during the four years preceding the conversion and the taxes which would have been paid if the property had been taxed according to its market value during this four-year period.

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[1]Although Montana enacted its differential assessment statute in 1973, this action simply legitimized the de facto differential assessment system which had been in effect in the state for a number of years. In 1963 the former state Board of Equalization directed county assessors to assess agricultural property according to a use-value schedule similar to the one now in use. Since then farm and ranch land has been assessed preferentially despite the existence of a state law (section 84-401, R.C.M. 1947) which until 1973 required that all land be assessed at "its full cash value."

The proliferation of differential assessment statues appears to have been primarily attributable to the belief that in the past the agricultural community has borne a disproportionate share of the tax burden. However, many of the concept's advocates believe that it responds to the broader and more important public need to preserve our food-producing resources. They argue that tax assessments based on market value are frequently so inflated by development and speculative pressures that they become a major factor in many decisions to convert productive land to less desirable, non-agricultural uses. It follows that by improving the economic climate for agricultural enterprise and (in the case of "roll back" measures) by penalizing the conversion of farm land, differential assessment statutes will insure a better use of land. This view has gained widespread popular support during the recent upsurge of interest in environmental and ecological matters and in land use planning. It is the purpose of this paper to explore this position and to examine the viability of Montana's differential assessment statute as a technique for discouraging development of agricultural lands.

What Constitutes Agricultural Use?

Frequently the most complex (and, in the case of the Montana statute, the most troublesome) provision of a differential assessment statute is that which specifies what agricultural uses will qualify land for preferred tax treatment. This section determines the scope of the law's application and must be carefully drawn to exclude from its purview uses which are only incidental to the primary use of the land involved or which are intended to camouflage short-term speculative objectives. Accordingly, it often establishes a combination of eligibility criteria relating to such matters as the area, historical use, and productivity

of the land and the proportion of the land owner's income derived from it.

The difficulty of developing satisfactory eligibility criteria for agricultural uses is well illustrated by the tortuous legislative evolution of Montana's differential assessment law. As originally enacted in 1973 Montana's differential assessment law provided that land was entitled to use-value assessment if:

(1) it was actively devoted to agriculture;
(2) the area of the land was at least five acres and the gross value of grazing land and of field crops produced thereon combined with any payments received under a cropland retirement program totaled at least $1,000 per year; or
(3) its agricultural production accounted for 15 percent or more of the owner's annual gross income (Section 4, Chapter 512, Session Laws, 1973).

In 1974 the legislature refined these original criteria by specifying that land was "devoted to agricultural use" if: 1) it was used to produce crops including, but not limited to, grains, feed crops, fruits, or vegetables; 2) it was used for grazing; or 3) it was in a cropland retirement program. Additional 1974 amendments declared that land used to produce crops for home consumption, as well as commercial farm and ranch land, was entitled to differential assessment (Sec. 2, Chap. 56, Session Laws, 1974).

Finally, the eligibility section (Section 84-437.2, R.C.M. 1947) was amended by

the 1975 Legislative Assembly (Sec. 1, Chap. 457, Session Laws, 1975) and in its present form reads as follows:

> 84-437.2. Eligibility of land for valuation as agricultural. (1) Land which is actively devoted to agricultural use shall be eligible for valuation, assessment and taxation as herein provided each year it meets either of the following qualifications:
>
> (a) The area of such land is not less than five (5) contiguous acres when measured in accordance with provisions of section 84-437.6, R.C.M. 1947, and it has been actively devoted to agriculture during the last growing season and it continues to be actively devoted to agricultural use which means;
>
> (i) it is used to produce field crops including, but not limited to, grains, feed crops, fruits, vegetables; or
>
> (ii) it is used for grazing; or
>
> (iii) it is in a crop-land retirement program; or
>
> (b) It agriculturally produces for sale or home consumption the equivalent of fifteen percent (15%) or more of the owners' annual gross income regardless of the number of contiguous acres in the ownership.
>
> (2) Land shall not be classified or valued as agricultural if it is subdivided with stated restrictions prohibiting its use for agricultural purposes.
>
> (3) The grazing on land by a horse or other animals kept as a hobby and not as a part of a bona fide agricultural enterprise shall not be considered a bona fide agricultural operation.

Although all of the changes made since the law's enactment appear to be designed to narrow its application to only bona fide agricultural activities, it remains to be seen whether the present language achieves this purpose.

The Roll-Back Tax

Although preferential assessment of agricultural land undoubtedly enhances the financial position of the farmer and rancher, most observers agree that, by itself, it does not significantly influence decisions to convert agricultural land to non-agricultural uses. Consequently many differential assessment statutes also impose a penalty for such conversion in the form of a "roll-back"

tax. The Montana statute, for example, contains the following provisions:

> When land which is or has been in agricultural use and is or has been valued, assessed and taxed under the provisions of this act, is applied to a use other than agricultural, it shall be subject to an additional tax hereinafter referred to as the "roll-back tax," which tax shall be a lien upon the land and become due and payable at the time of the change in use.
>
> As used in this act, the word "roll-back" means the period preceding the change in use of the land not to exceed four (4) years during which the land was valued, assessed and taxed under the provisions of this act. (Section 84-437.4, R.C.M. 1947)

Because the roll-back feature of Montana's use-value assessment law did not become effective until 1975[2] it is impossible to do more here than speculate as to the effect it will have on the use of farm land. It may be said, however, that the impact of the roll-back tax, particularly on the subdivision of land, will depend largely on the interpretation given to the phrase "at the time of the change of use." For example, does the filing of a subdivision plat constitute a change of use (in which case the subdivider would be liable for the tax) or does the change take place only when the physical use of the land changes (in which case the unsuspecting lot buyer would find himself liable for the tax)? If the latter is the case, any deterrent effect the statute might otherwise have on the subdivision of agricultural land would be lost. The argument can, of course, be made that a subdivider is the initiator of a change of land use and that because his primary interest in the land is speculative he should not be entitled to preferential tax treatment intended to benefit the agricultural community. On the other hand if his physical use of the land meets the eligibility criteria of the statute, can he legally be excluded from its application?

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[2] In a letter opinion dated November 19, 1974, the Attorney General of Montana declared that the roll-back tax provided by the state's differential assessment statute may not be imposed retrospectively for the years preceding the 1974 effective date of the statute. Under this opinion the maximum roll-back period would be one year in 1975, two years in 1976, three years in 1977, and four years in 1978 and thereafter.

Whether the change in use of a portion of an agricultural tract triggers the imposition of the roll-back tax on the entire tract or only on the portion of the tract actually affected will also affect the degree to which the roll-back discourages the conversion of agricultural land.

Finally, assuming that the preceding questions can be satisfactorily answered, how effective will a four-year roll-back tax be in deterring the conversion of agricultural land to non-agricultural use. The following hypothetical example, based on current market conditions and assessment rates, suggests that the impact of Montana's roll-back tax on land use will be negligible:

A parcel of irrigated farm land located within five miles of Billings, Montana, may have a market value of $2,000 per acre and an assessed value for agricultural use of $75 per acre. With a county mill levy of .128 this parcel is taxed under the differential assessment law as follows:

$75/acre (assessed value)	x	.3 (taxable value rate)[3]	=	$22.50/acre (taxable value)
$22.50/acre (taxable value)	x	.128 (mill levy)	=	$2.88/acre (property tax)

[3]By statute the taxable value of land is 30 percent of its assessed value (sections 84-301 and 84-302, R.C.M. 1947)

If this parcel were assessed according to its market value, the property tax would be computed as follows:

$2,000/acre (market value)	x	.4 (assessment rate)[4]	=	$800/acre (assessed value)
$800/acre (assessed value)	x	.3 (taxable value rate)	=	$240/acre (taxable value)
$240/acre (taxable value)	x	.128 (mill levy)	=	$30.72/acre (property tax)

If this parcel were converted to non-agricultural use, the roll-back tax would be calculated as follows:

$30.72/acre (tax based on market value)	-	$2.88/acre (tax under differential assessment law)	x	4 (four-year roll-back)	=	$111.36/acre (roll back tax)

Assuming that a land speculator who acquired this land for $2,000 per acre will expect to invest $2,000 per acre in development cost and sell the subdivided lots for $6,000 per acre,[5] it seems unlikely that an additional charge of $111.36 per acre will significantly affect the marketability of the lots or the decision to subdivide the land.

Evaluating Differential Assessment

One obvious solution to the problem described above would seem to be to increase

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[4] Section 84-401, R.C.M. 1947, provides that all land other than agricultural and mining property must be assessed at 40 percent of its full cash market value.

[5] A one-third acquisition cost, one-third development cost, one-third profit margin rule of thumb is commonly employed by land development interests to assess the economic feasibility of a proposed project. The guideline is used here for illustrative purposes only and may not accurately reflect actual investment or profit expectations.

the roll-back period until the resulting tax is large enough to price converted agricultural land out of the market. Advocates of this approach believe that a 10-year penalty is necessary to achieve the Act's land use objectives and, during both the 1974 and the 1975 legislative sessions, they attempted, unsuccessfully, to extend Montana's roll-back by six years. These efforts have been based on the erroneous assumption that if it could be strengthened, the present Montana act would favorably influence land use in the state. Unfortunately, there is convincing evidence to suggest that the opposite is true -- that if the existing statute were "given teeth," it would encourage the development of Montana's best agricultural land and contribute to inefficient and environmentally harmful "leapfrog" development.

From the standpoint of land use planning the most serious weakness of the Montana law is that its roll-back is determined by subtracting actual taxes assessed according to the agricultural value of the land in question from the taxes that would have been assessed at its undeveloped market value. Because agricultural taxes are higher for productive land than for poor land, the paradoxical result of this system is that, all things being equal, the greater the value of the land for agriculture, the lower will be the roll-back tax when the land is taken out of production. Although it was clearly not the intention of the legislature to penalize the conversion of marginal land more harshly than the conversion of prime land, that is the effect of the statute.

A related problem concerns the locational influence of the statute. A fundamental tenet of land use planning is that "leapfrog" urban expansion, which leaves unplanned gaps of vacant land between enclaves of residential, commercial

or industrial development, is undesirable because it fosters urban sprawl, promotes premature subdivision, and greatly increases the cost of providing public services. However, if the roll-back provision of Montana's differential assessment statute were strengthened sufficiently to affect land use decisions, it would actually encourage such development. This incongruity would result from the interaction of two factors. First, under the statute, the roll-back tax varies directly with the undeveloped market value of the land in question. Accordingly, the less valuable the land is for non-agricultural purposes, the lower will be the roll-back tax when it is taken out of agricultural production. Second, as a general rule the farther land lies from an urban center, the less valuable it is for development purposes. (This relationship is less clear when land is desirable for second home or recreational development.) Thus, the statute tends to encourage the conversion of land located at a distance from existing urban areas and to discourage urbanization of land adjacent to cities and towns.

A third deficiency of the Montana statute is that is applies indiscriminately to all land which meets its broad eligibility criteria without regard to location or quality, or to the presence or absence of development pressure on the land. Few would argue that all agricultural land can (or should) be protected from development. Consequently, it is the task of land use planners to distinguish productive from marginal land and to develop methods of discouraging development of the former. Because it lacks this important planning element, Montana's differential assessment law provides tax windfalls to owners of property in areas where there is no development pressure and penalizes development of land which may be best suited for urban growth.

Recommendations

If it is true that Montana's differential assessment statute not only fails to encourage proper land use decisions but also is at odds with accepted land planning principles, what can be done to remedy the situation? For the reasons discussed above, a simple increase of the term of the present roll-back provision must be rejected as simplistic and counter-productive. However, more satisfactory alternatives do exist. First, it may be desirable to segregate the law's objective of reducing the tax burden of farmers and ranchers from its land use function by addressing these two concerns in separate statutes. This would allow the preferential tax treatment of all agricultural enterprises (assuming that this is desirable) without regard to land planning considerations. Second, the resulting land use statute should apply selectively to only that agricultural land whose protection is warranted by its productivity, strategic location, or other social significance. Finally, the penalty for removing designated land from agricultural production should be strengthened and restructured, perhaps by relating it to the income attributable to the conversion. In the alternative, conversion of the land could be prohibited outright.

One technique, agricultural districting, responds to all three of these recommendations and seems particularly well suited to the task of preserving Montana's agricultural land base. This approach, which has been adopted in different forms by California, New York, and Oregon, combines features of traditional planning and zoning with those of differential assessment statutes. Under this hybrid system local governing bodies (and, in the case of New York, the state) may create districts in which the conversion of land to non-agricultural use is

prohibited.[6] The formation of these districts may be initiated by property owners or by the designating governmental agency, but in either case it must conform to a comprehensive plan for the affected area. Once land has been included in an agricultural district, it is entitled to use-value property tax assessment and, under the New York and Oregon laws, is exempt from special levies for sewer and water districts.

Because agricultural districting is selective in its application and provides positive control over land use through zoning, it overcomes the weaknesses of standard differential assessment while incorporating the benefits of use-value taxation. However, the citizens of Montana and their elected representatives are unlikely to embrace this or any other effective device for preserving productive land until they become convinced that the vitality of the state's agricultural industry is actually being threatened by the unchecked erosion of our land resource. The continued preeminence of this industry is essential if Montana is to achieve many of its stated social, economic, and environmental goals. Thus it is imperative that the state recognize the deficiencies of its present approach to agricultural land preservation and take the actions necessary to remedy these inadequacies.

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[6]The weak New York statute, which relies solely on economic incentives, simply provides for a five year roll-back penalty in the event that land is converted to another use.

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